

In the Matter of the Application of)  
SOUTH KOHALA WASTEWATER CORP. )  
For Review and Approval of Rate )  
Increases; Revised Rate Schedules. )  
\_\_\_\_\_ )

Commission, State of Hawaii.  
K. H. Grob.

## TABLE OF CONTENTS

I.	BACKGROUND	2
A.	South Kohala Wastewater Corp.	2
B.	SKWC's Application	4
C.	Act 168	7
D.	Public Hearing	8
E.	Stipulated Issues	9
F.	Discovery	9
II.	THE PARTIES' STIPULATION	10
A.	Summary of the Parties' Stipulation	12
B.	Operating Revenues	12
C.	Operating Expenses	15
1.	Salaries and Wages, Payroll Taxes, Employee Benefits and Pension	16
2.	Amortization	16
3.	Professional Fees	18
4.	Utilities	18
5.	Contractor Services	19
6.	Expense Transferred From Affiliate	19
7.	Revenue Taxes and Income Taxes	20
D.	Rate Base	21
E.	Rate of Return	22
F.	Rate Design	23
G.	Operating Reserve	24
H.	Rules and Regulations	26
III.	ULTIMATE FINDINGS AND CONCLUSIONS	27
IV.	ACCEPTANCE OR NON-ACCEPTANCE	29
V.	ORDERS	30

## EXHIBIT A

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of)  
SOUTH KOHALA WASTEWATER CORP. )  
For Review and Approval of Rate )  
Increases; Revised Rate Schedules. )  

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Docket No. 05-0333  
Proposed Decision and  
Order No. **22577**

PROPOSED DECISION AND ORDER

By this Proposed Decision and Order, the commission approves a general rate increase of \$271,168, or 40.01% over revenues at present rates for SOUTH KOHALA WASTEWATER CORP. ("SKWC") for the test year ending December 31, 2006 (the "Test Year").<sup>1</sup> In so doing, the commission approves the "Stipulation of Settlement Agreement in Lieu of [SKWC's] Rebuttal Testimonies," jointly filed by SKWC and the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS, DIVISION OF CONSUMER ADVOCACY ("Consumer Advocate")<sup>2</sup> (jointly, the "Parties"), on June 22, 2006.<sup>3</sup>

Specifically, the commission approves: (1) an annual revenue increase of \$271,168, or 40.01% over revenues at present

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<sup>1</sup>The commission issues this Proposed Decision and Order, as mandated by Act 168, Session Laws of Hawaii 2004 ("Act 168"), codified at Hawaii Revised Statutes ("HRS") § 269-16(f).

<sup>2</sup>The Consumer Advocate is an *ex officio* party to this docket pursuant to HRS § 269-51 and Hawaii Administrative Rules ("HAR") § 6-61-62.

<sup>3</sup>Stipulation of Settlement Agreement in Lieu of Rebuttal Testimonies, Exhibits A through D, and Certificate of Service, filed on June 22, 2006 (the "Stipulation").

rates, which represents an increase in SKWC's revenue requirement to \$1,030,555;<sup>4</sup> (2) a total Test Year amortization expense amount of \$23,050, and an amortization period of four years; (3) a Test Year average rate base of \$446,544, which excludes a working cash amount that was originally requested by SKWC of \$69,031; (4) a rate of return of 8.85% on SKWC's Test Year average capital rate base; and (5) the continuation of SKWC's operating reserve (which the Consumer Advocate initially proposed to be terminated), but at a reduced rate of 6.5% of the approved monthly user fee rates for all customers.

I.

Background

A.

South Kohala Wastewater Corp.

SKWC is a public utility providing wastewater treatment service to residences, hotels, and commercial establishments in

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<sup>4</sup>The commission notes that this figure is exactly \$1 less than the Parties' stipulated figure for Total Operating Revenues (\$1,030,556), which is listed in Exhibit A, attached to the Parties' Stipulation. It appears, however, on the face of the Parties' Exhibit A that the Parties' figure is a miscalculation (i.e., \$948,926 (User Rates) + \$80,629 (Sale of Effluent) + \$1,000 (Inspection Fees) + 0 (Contribution for Replacement) = \$1,030,555 (Total Operating Revenues)). Because this difference is de minimis, the commission nevertheless approves the Parties' Stipulation, but as more accurately set forth in the commission's attached Exhibit A. In this regard, the commission further notes that a \$1 adjustment was also made to the Parties' figure of \$271,169 -- the amount of their agreed-upon general rate increase. Instead, as shown on Exhibit A, attached hereto, the commission approves a general rate increase of \$271,168 (\$1,030,555 (Total Operating Revenues at Proposed Rates) - \$759,387 (Total Operating Revenues at Present Rates) = \$271,168 (Additional Amount of Total Operating Revenues)).

the South Kohala area on the Big Island of Hawaii. The commission issued SKWC its Certificate of Public Convenience and Necessity ("CPCN") in November 1997, pursuant to HRS § 269-7.5(b).<sup>5</sup>

As discussed in the audited financial statement provided by SKWC as Exhibit SKWC-2,<sup>6</sup> SKWC is a wholly-owned subsidiary of Moani Corp., whose ultimate parent is Seibu Railway Company, Ltd. Exhibit SKWC-2 also indicates that Moani Corp. is a wholly-owned subsidiary of Kohala Corp., which is a wholly-owned subsidiary of Lokelani Resort Corp., a Hawaii corporation. Lokelani Resort Corp. is a wholly-owned subsidiary of Seibu Railway Company.

SKWC's wastewater treatment plant is an extended air, secondary activated sludge treatment facility. SKWC further describes its facility as "a Smith and Loveless designed Oxigest system comprised of two (2) complete units for redundancy."<sup>7</sup> Each unit is designed to handle 300,000 gallons per day. The peak hydraulic capacity for the system is 1.267 million gallons per day. A full-time Plant Manager, one Operator, and two Operator Assistants are currently employed by SKWC to operate the facility.

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<sup>5</sup>Decision and Order No. 16054, filed on November 4, 1997, in Docket No. 96-0081 ("Decision and Order No. 16054").

<sup>6</sup>See SKWC's Application, Exhibits SKWC 1 to SKWC 13, Verification, and Certificate of Service, filed on December 30, 2005 (collectively, the "Application"), at Exhibit SKWC-2.

<sup>7</sup>Application, Exhibit SKWC 1, at 1.

The SKWC facility is intended to serve the Mauna Kea Beach Hotel, Mauna Kea Golf Course Clubhouse, Hapuna Beach Prince Hotel, and the Hapuna Golf Clubhouse. The facility is also intended to serve a number of residential developments, including The Bluffs at Mauna Kea, Kaunaoa Estates, High Bluffs, Kumulani Development, Wai`ula`ula Development, "and other future developments."<sup>8</sup> SKWC's residential customer base is divided into two classes -- single-family units and multi-family dwellings. A network of gravity sewer mains and force mains serves the service area, along with three sewer pump stations and one grinder pump, which comprise the collection system for the wastewater facility and users.

SKWC states that, after disinfection, wastewater effluent at its facility is referred to as R-2 water and is suitable for regulated irrigation. This treated water flows by gravity into a 500,000 gallon reservoir that is located north of the facility. The Mauna Kea Golf Course then pumps this water into their irrigation system and uses it to water three of their fairways.

B.

#### SKWC's Application

On December 30, 2005, SKWC filed its Application, requesting the commission's approval of a general rate increase of approximately \$312,539, or approximately 46% over total revenues at present rates. The requested increase is based on an

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<sup>8</sup>Id.

estimated total revenue requirement of \$1,101,359 for the Test Year. SKWC makes its request pursuant to: (1) HRS § 269-16, as recently amended by Act 168; and (2) HAR § 6-61-88.

In support of its Application, SKWC states that: (1) its Application represents its first request for an increase in its wastewater rates since its initial rates were approved in 1997; (2) since then, its operating expenses have significantly increased over its operating revenues, such that its current revenues are insufficient to cover its operating expenses; and (3) by its Application, it seeks to eliminate its significant operating losses, and achieve a reasonable return on investment on its approved test year rate base.

By Decision and Order No. 16054, filed on November 4, 1997, in Docket No. 96-0081, SKWC was granted an approved test year rate base of \$91,666, and a reasonable rate of return of said rate base at 10%.<sup>9</sup> In its present Application, SKWC seeks to obtain approval for an increase in its approved test year rate base, for a requested rate base of \$515,575. SKWC also seeks a 10% reasonable rate of return on its requested rate base.

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<sup>9</sup>In Docket No. 96-0081, SKWC did not seek to include the cost of its facilities in its approved rate base, but "reserved the right to raise the issue of including the costs of the wastewater treatment plant that was in service at the beginning of the test year in its rate base in future ratemaking proceedings." See Decision and Order No. 16054, at 7 n.2.

As set forth in its Application, SKWC's present and proposed rates are as follows:

	<u>Present</u>	<u>Proposed</u>	<u>Change in amount</u>	<u>Percentage increase</u>
<b><u>Service Charges</u></b>				
Single Family	\$55.25	\$80.69	\$25.44	46%
Multi-Family	\$44.17	\$64.56	\$20.39	46%
Hotel (per room)	\$63.09	\$92.19	\$29.10	46%
Commercial (per 1,000 gallons of water used)	\$4.54	\$6.63	\$2.09	46%
<b><u>Operating Reserve</u></b>				
Single Family	\$5.53	\$8.07	\$2.54	46%
Multi-Family	\$4.42	\$6.46	\$2.04	46%
Hotel (per room)	\$6.31	\$9.22	\$2.91	46%
Commercial (per 1,000 gallons of water used)	\$0.45	\$0.66	\$0.21	46%

As indicated above, SKWC currently maintains an operating reserve, which it was authorized to establish and maintain in Decision and Order No. 16054 when SKWC's current rates were approved in 1997. More specifically, Decision and Order No. 16054 authorized SKWC to charge a 10% override on its approved service rates in order to fund the operating reserve.



The funds in the operating reserve are for the purpose of paying for significant repairs, replacements, and unusual and extraordinary operating contingencies over and above the normal maintenance requirements. In its present Application, SKWC seeks approval to continue this operating reserve account, while also requesting, as discussed above, an increase in its rate base and an opportunity to earn a reasonable rate of return thereon.

SKWC served copies of its Application on the Consumer Advocate. The Consumer Advocate did not object to the completeness of SKWC's Application.<sup>10</sup> Hence, the filing date of SKWC's complete Application is December 30, 2005, consistent with HRS §§ 269-16(d) and (f)(3).

C.

Act 168

As a public utility with annual gross revenues of less than \$2 million, SKWC's Application is filed in accordance with Act 168, which streamlines the rate review process for small utilities such as SKWC. In brief, the commission must make every effort to issue its Proposed Decision and Order within six months from the filing date of SKWC's complete Application, "provided that all parties to the proceeding strictly comply with the procedural schedule established by the commission and no person is permitted to intervene." HRS § 269-16(f)(3).

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<sup>10</sup>Consumer Advocate's Statement of Position Regarding Completeness of Application, filed on January 18, 2006, in accordance with HRS § 269-16(d).

The commission timely issues this Proposed Decision and Order, in accordance with Act 168.<sup>11</sup>

D.

Public Hearing

On February 15, 20, 27, and March 6, 2006, the commission published its Notice of Public Hearing statewide in various newspapers, in accordance with HRS §§ 1-28.5 and 269-16(c).<sup>12</sup> SKWC notified its customers of the public hearing by means of a letter mailed to all customers on February 24, 2006, consistent with HRS § 269-12(c).<sup>13</sup>

On March 8, 2006, the commission held a public hearing on SKWC's Application at the Waimea Civic Center in Kamuela, Hawaii, pursuant to HRS §§ 269-12(c) and 269-16(f)(2). At the public hearing, SKWC's representative and the Consumer Advocate orally testified and submitted written comments. One ratepayer appeared and testified in support of the rate increase.

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<sup>11</sup>The deadline for issuance is June 30, 2006. See Stipulated Procedural Order No. 22352, filed on March 24, 2006 ("Order No. 22352").

<sup>12</sup>Specifically, the commission's Notice of Public Hearing was published in The Garden Island, Hawaii-Tribune Herald, Honolulu Star-Bulletin, The Maui News, and West Hawaii Today.

<sup>13</sup>See Letter dated and filed March 1, 2006 from SKWC to the commission.

E.

Stipulated Issues

The Parties submitted a Stipulated Procedural Schedule, which was filed on March 24, 2006 as Stipulated Procedural Order No. 22352. As set forth in Order No. 22352, the underlying issue in this case is the reasonableness of SKWC's proposed general rate increase. This involves, in turn, a review of the following sub-issues:

1. Are the proposed tariffs, rates, and charges just and reasonable?
2. Are the revenue forecasts for the Test Year at present and proposed rates reasonable?
3. Are the projected operating expenses for the Test Year reasonable?

F.

Discovery

In Stipulated Procedural Order No. 22352, the Parties also agreed to a schedule for discovery. Pursuant to this schedule, on March 17, 2006 and March 30, 2006, the Consumer Advocate filed its First Submission of Information Requests and its Supplemental Information Requests, respectively.<sup>14</sup> SKWC responded to the Consumer Advocate's First Submission of

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<sup>14</sup>In the interest of expediting its review of the Application, the Consumer Advocate actually informally issued its First Submission of Information Requests on February 3, 2006. The Consumer Advocate thereafter formally filed its First Submission of Information Requests on March 17, 2006.

Information Requests on March 15, 29, and 30, 2006; it responded to the Consumer Advocate's Supplemental Information Requests on April 13 and 17, 2006.

On May 16, 2006, the Consumer Advocate submitted its Direct Testimony, Exhibits and Supporting Workpapers.<sup>15</sup>

On June 22, 2006, the Parties jointly filed their Stipulation, supported by the Parties' worksheets, data, and other information.

## II.

### The Parties' Stipulation

The Stipulation reflects the Parties' global settlement of all the issues under HAR § 6-61-35. In reaching their global agreement, the Parties note:

1. The Stipulation, binding between them, "represent[s] compromises by the Parties to fully and finally resolve all issues in the subject docket on which they had differences for the purpose of simplifying and expediting this proceeding, and are not meant to be an admission by either of the Parties as to the acceptability or permissibility of [the] matters stipulated to herein."<sup>16</sup>
2. They reserve their respective rights to proffer, use, and defend different positions, arguments, methodologies, or claims regarding stipulated matters in other dockets or proceedings.
3. They "have stipulated to the various revenue requirement components and matters discussed in [the Stipulation] as being appropriate, without

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<sup>15</sup>Division of Consumer Advocacy's Direct Testimony, Exhibits and Supporting Workpapers, filed on May 16, 2006 (collectively, "Consumer Advocate's Direct Testimony").

<sup>16</sup>Stipulation, at 5.

necessarily agreeing on the underlying methodologies or justifications asserted by the other party."<sup>17</sup> Moreover, "nothing contained in this Stipulation shall be deemed to, nor be interpreted to, set any type of precedent, or be used as evidence of either Parties' position in any future regulatory proceeding, except as necessary to enforce this Stipulation."<sup>18</sup>

4. Each provision of the Stipulation is in consideration and support of all other provisions, and is expressly conditioned upon the commission's acceptance of the Stipulation in its entirety.

"In the event the Commission declines to adopt parts or all of the matters agreed to by the Parties and as set forth in this Stipulation, the Parties reserve the right to pursue any and all of their respective positions through further negotiations and/or additional filings and proceedings before the Commission."<sup>19</sup>

5. "[T]he Commission may take such steps and actions it deems necessary and appropriate to facilitate its review of this Stipulation, and to determine whether this Stipulation should be approved."<sup>20</sup>

The Parties also acknowledge that the Stipulation is subject to the commission's review and approval, and the commission is not bound by the Stipulation.<sup>21</sup> In this regard, it is well-settled that an agreement between the parties in a rate case cannot bind the commission, as the commission has an independent obligation to set fair and just rates and arrive at

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<sup>17</sup>Id.

<sup>18</sup>Id.

<sup>19</sup>Id. at 19.

<sup>20</sup>Id.

<sup>21</sup>Id. at 1.

its own conclusion. See In re Hawaiian Elec. Co., Inc., 5 Haw. App. 445, 698 P.2d 304 (1985). With this mandate, the commission proceeds in reviewing the justness and reasonableness of the Parties' Stipulation, taken as a whole.

A.

Summary of the Parties' Stipulation

The Parties have stipulated to a revenue requirement of \$1,030,555 for the Test Year, resulting in a revenue increase of \$271,168, or approximately 40.01% over the user fee revenues at present rates. As shown on Exhibit A, attached hereto, the Parties agree that the result of the Stipulation is to allow SKWC an opportunity to recover an 8.85% rate of return on SKWC's average Test Year rate base of \$446,544, which amounts to an operating income figure of \$39,519.

The Parties also reached a settlement on SKWC's request to continue to maintain its operating reserve. In this regard, the Parties agree that SKWC may continue to maintain the operating reserve by charging an additional 6.5% on its newly approved monthly user fee rates for all classes of customers. The 6.5% charge is a reduction from SKWC's currently approved 10% assessment.

B.

Operating Revenues

SKWC's sources of revenues for wastewater treatment operations are derived from the following: (i) user fee revenues

from residential customers; two hotels; and nine commercial accounts associated with the hotels; (ii) effluent sales; and (iii) inspection fees. SKWC's proposed Test Year revenue projection at its present rates is \$759,387, which consists of \$677,758 in user fee revenues, \$80,629 in effluent sales, and \$1,000 in inspection fees.<sup>22</sup>

SKWC's hotels and residential customers are charged a flat monthly rate for wastewater service. The hotels' monthly assessment is based on the number of rooms that are available at each establishment. The nine commercial establishments associated with the hotels are charged a volumetric rate for wastewater service provided by SKWC based on the volume of water used by each establishment.<sup>23</sup>

In its Direct Testimony, the Consumer Advocate noted that 86.1% of SKWC's operating revenues are derived from the fees received from the hotel and commercial establishments, and that these operations are owned and operated by affiliates of SKWC. The remaining 13.8% of the revenues are derived from the fees charged to residential customers. The Consumer Advocate expressed concern that, due to the flat rate structure, there is

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<sup>22</sup>See Application, Exhibit SKWC 13, at 1.

<sup>23</sup>As discussed in the Consumer Advocate's Direct Testimony, because of the high cost of installing meters to measure the volume of wastewater generated by a customer, it is common practice to use water use as a surrogate for wastewater flows generated, when such water data is readily available to the utility providing the wastewater treatment service. An exception would be for water used for irrigation purposes because such water generally does not flow into the wastewater treatment system, and instead percolates into the ground. See Consumer Advocate's Direct Testimony, at 9-10.

a potential for residential customers to subsidize the operations of the hotels and commercial operations. Thus, the Consumer Advocate recommended that the commission consider whether a different rate design with both a fixed and volumetric rate may better recover the costs of providing service from each of SKWC's customer classes prior to the next rate case.

The Consumer Advocate, however, made no adjustments to SKWC's proposed Test Year revenue projections at present rates. Although SKWC and the Consumer Advocate had different revenue requirement projections at proposed rates, these differences were a result of differing expense, rate of return, and working cash recommendations, as discussed more fully below. Given the Parties' global settlement of these, and all other issues in this case, the Parties reached an agreement on SKWC's Test Year total operating revenues in the amount of \$1,030,555. The Parties agree that this figure is derived from \$948,926 in user fee revenues at proposed rates, \$80,629 from effluent sales, and \$1,000 from authorized inspection fees.

The commission finds reasonable the Parties' stipulated amount for SKWC's Test Year total operating revenues. The commission further finds that the Consumer Advocate's recommendation to explore in SKWC's next rate proceeding, whether a different rate design, consisting of both a fixed and volumetric rate, may better recover the costs of providing service from each of SKWC's customer classes, is reasonable. In its next rate proceeding, SKWC is directed to consider the



feasibility of preparing a cost of service study, and modifying its current rate design based on the results of such study.

C.

Operating Expenses

SKWC projected an unadjusted operating expense level for the Test Year of \$884,227, net of Contribution for Replacement.<sup>24</sup> In its Direct Testimony, the Consumer Advocate recommended a Test Year operating expense projection of \$830,567.<sup>25</sup> The Parties have agreed on an amount of \$864,610 for SKWC's Test Year unadjusted operating expense level, and an amount of \$991,036 for SKWC's Test Year total operating expenses (including revenue taxes, depreciation, and income taxes). See Exhibit A, attached hereto.

In reviewing SKWC's projected operating expense levels, the Consumer Advocate first identified key categories of expenses that comprised a significant portion of SKWC's total projected Test Year operating expense levels. The Consumer Advocate then focused on these different key categories, and made a determination on the reasonableness of SKWC's Test Year projections. A discussion of these expense categories follows below.

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<sup>24</sup>See Application, Exhibit SKWC 9, at 1.

<sup>25</sup>See Consumer Advocate's Direct Testimony, at 12.

1.

Salaries and Wages, Payroll Taxes, Employee Benefits and Pension

SKWC's Test Year projections for salaries and wages, payroll taxes, employee benefits and pension expenses totaled \$308,531.<sup>26</sup> In its review of these projections, the Consumer Advocate compared SKWC's salary and wage information to comparable information of other public utilities providing wastewater treatment service on the island of Hawaii.<sup>27</sup> Based on this comparison, the Consumer Advocate determined that SKWC's Test Year salary and wage projections appeared reasonable.

Further, the Consumer Advocate reasoned that SKWC's projections for payroll taxes, and employee benefits and pensions were all directly related to the projected salary and wage levels for employees. For these reasons, the Consumer Advocate did not recommend any adjustment to SKWC's Test Year salary and wage expense projection of \$210,055, payroll tax expense projection of \$16,821, employee benefit expense projection of \$36,255, and pension expense projection of \$45,400.<sup>28</sup> The commission finds reasonable these agreed-upon amounts by the Parties.

2.

Amortization

SKWC proposed a Test Year amortization amount of \$128,000. SKWC proposed to amortize this expense over a

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<sup>26</sup>See Application, Exhibit SKWC 9, at 1.

<sup>27</sup>See Consumer Advocate's Direct Testimony, at 14.

<sup>28</sup>See id. at 15.

three-year period, resulting in \$42,667 of amortization expense for the Test Year.<sup>29</sup>

In its Direct Testimony, the Consumer Advocate proposed a total rate case expense of \$92,200, which would be amortized over a five-year period, resulting in a Test Year rate case expense of \$18,440.<sup>30</sup> The Consumer Advocate based its recommendations on the following adjustments:

- (1) Increase the estimate for the preparation and filing phase in this proceeding by \$3,700 to reflect the actual cost incurred by SKWC of \$51,700 (according to SKWC's response to CA-IR-21);
- (2) Remove the estimated \$39,000 in costs associated with the hearing and briefing phase in this proceeding; and
- (3) Remove the miscellaneous cost of \$500 included in SKWC's estimate of costs for discovery and settlement.<sup>31</sup>

During settlement discussions, the Parties reached a compromise. The Parties agreed to a Test Year rate case expense of \$92,200, and an amortization period of four years. This figure, combined with the other agreed-upon Test Year amortization expense levels, results in a total agreed-upon

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<sup>29</sup>See Application, Exhibit SKWC 6.

<sup>30</sup>See Consumer Advocate's Direct Testimony, at 15-24.

<sup>31</sup>See id.

Test Year amortization expense amount of \$23,050. The commission finds the Parties' stipulated Test Year amortization amount, and the stipulated four-year amortization period, to be just and reasonable in this case.

3.

Professional Fees

SKWC projected professional fees in the amount of \$49,860, representing accounting (\$15,700), legal (\$25,000), engineering (\$2,000), and other professional (\$7,160) services that are expected to be required during the Test Year.<sup>32</sup> Based on SKWC's confidential responses to CA-IR-23, the Consumer Advocate determined that SKWC's Test Year projection of \$49,860 was reasonable, and therefore, did not object to SKWC's proposed projection.<sup>33</sup> The commission also finds that SKWC's projection for professional fees is reasonable.

4.

Utilities

SKWC's forecasted utility expense is \$251,600, representing the cost of electricity required to pump the wastewater through the treatment system. The Consumer Advocate contends that the \$251,600 amount is reasonable. Although the amount represents an increase over historical amounts, SKWC will

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<sup>32</sup>See Application, Exhibit SKWC 9, at 1.

<sup>33</sup>See Consumer Advocate's Direct Testimony, at 24.

be activating a second treatment facility in the Test Year, and will be adding three odor control units. Based on historical charges from HELCO, the addition of new facilities that will consume electricity, and the recent trend of increasing electricity rates due to the rising cost of fuel, the Consumer Advocate does not object to SKWC's utilities expense forecast. Likewise, the commission finds reasonable the Parties' agreed-upon utilities expense forecast for SKWC.

5.

Contractor Services

SKWC projected a Test Year contractor services amount of \$63,000.<sup>34</sup> This expense represents the monies projected to be paid to SKWC's affiliates for various services shown on SKWC's confidential response to CA-IR-24, Workpaper 2. Based on the information provided by SKWC in this response, the Consumer Advocate determined that this projected amount was reasonable. The commission also finds this projected expense to be reasonable.

6.

Expense Transferred From Affiliate

The expense transfer from affiliate amount represents one-half of the costs incurred by SKWC's affiliate, Makena Wastewater Corp., for the salaries and related costs of the Vice President and Administrative Assistant who provide administrative

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<sup>34</sup>See Application, Exhibit SKWC 9, at 1.

support for both the operations of SKWC and Makena Wastewater Corp. For this expense, SKWC projected an amount of \$61,594 for the Test Year. Based upon a review of SKWC's confidential response to CA-IR-24, including the actual costs incurred from 2003 through 2005 as shown on Workpapers 1 and 2 of that response, the Consumer Advocate determined that SKWC's Test Year projection for expense transfer from affiliate was reasonable. The commission also finds that this projection is reasonable.

7.

#### Revenue Taxes and Income Taxes

The Consumer Advocate noted in its Direct Testimony that it utilized the same tax rates and methodology as SKWC in computing its Test Year projections for revenue taxes and income taxes. The differences between SKWC's projections and the Consumer Advocate's projections were due to the Parties' differing revenue projections for revenue taxes and the Parties' differing revenue and expense projections for income taxes.

The Parties have reached a settlement on a Test Year revenue tax figure of \$65,801, and a Test Year income tax figure of \$24,476 (as set forth in Exhibit A, attached hereto), and the commission finds these figures to be reasonable.

D.

Rate Base

SKWC requested a Test Year average capital rate base amount of \$515,575.<sup>35</sup> In its Direct Testimony, and as detailed further below, the Consumer Advocate recommended the elimination of a working cash component of SKWC's Test Year average capital rate base in the amount of \$69,031, resulting in an average rate base amount of \$446,544.<sup>36</sup>

As explained by the Consumer Advocate, utilities generally incur costs to provide regulated service prior to receiving compensation for such service through the bills rendered. Thus, working cash is included in rate base to recognize the amount of money provided by investors to pay the utility's current costs of providing utility service, pending receipt of revenues to be received for providing those services.<sup>37</sup>

The Consumer Advocate opposed the inclusion of working capital in SKWC's average rate base calculation because SKWC bills its residential and hotel customers monthly, in advance, for its wastewater service. Therefore, the Consumer Advocate asserted that SKWC should have sufficient cash on hand to pay its operating expenses before providing service. The Consumer Advocate did note that SKWC's commercial customers were not billed a flat monthly fee in advance, and instead, were assessed a volumetric fee based on the amount of potable water used.

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<sup>35</sup>See Application, Exhibit SKWC 9, at 1.

<sup>36</sup>See Consumer Advocate's Direct Testimony, at 28-32.

<sup>37</sup>See id. at 28.

These commercial customers, however, only contribute 12% of the total wastewater treatment revenues, whereas the residential and hotel customers who are billed in advance of service account for 88% of the wastewater treatment revenues.

For purposes of settlement, SKWC agreed to adopt the Consumer Advocate's recommendation that the working cash amount of \$69,031 be excluded from SKWC's requested Test Year average rate base. As such, the Parties agreed to a Test Year average rate base of \$446,544,<sup>38</sup> which the commission finds to be fair and reasonable in this case.

E.

#### Rate of Return

In its Application, SKWC requested an increase in its current rates to provide it with an opportunity to earn a 10% rate of return on its Test Year average rate base.<sup>39</sup> In its Direct Testimony, the Consumer Advocate contended that, in recent rate proceedings involving similar sized water utilities, rates of return lower than 10% have been deemed reasonable by the commission.<sup>40</sup> Accordingly, the Consumer Advocate objected to the proposed 10% rate of return, and proposed an 8.85% rate of return on SKWC's Test Year average capital rate base.

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<sup>38</sup>\$515,575 - \$69,031 = \$446,544.

<sup>39</sup>See Application, at 3.

<sup>40</sup>See Consumer Advocate's Direct Testimony, at 39 (citing, for example, the commission's decision in Decision and Order No. 21864, filed on June 14, 2002, in Docket No. 04-0298).



For purposes of settlement, SKWC agreed to adopt the Consumer Advocate's proposed 8.85% rate of return on SKWC's Test Year average capital rate base. Based on the justifications for this rate of return provided by the Consumer Advocate in its Direct Testimony, the commission finds that the Parties' stipulated rate of return of 8.85% is just and reasonable in this case.

F.

Rate Design

In its Application, SKWC initially requested a Test Year revenue requirement increase of approximately \$312,539.<sup>41</sup> The Application also explained that SKWC sought to implement this rate increase by implementing an across-the-board increase of 46% to the present monthly use fee rates for all customer classes, while continuing to collect monies to fund SKWC's operating reserve through the assessment of a 10% surcharge on the resulting proposed rates.<sup>42</sup> SKWC did not propose an increase to the rate for effluent sales to the golf course; nor did it propose an increase for the rate charged for inspecting the installation of new meters. SKWC did not prepare a cost of service study for this case.

In its Direct Testimony, the Consumer Advocate did not oppose an across-the-board rate increase, since the increase proposed by the Consumer Advocate was very similar to the

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<sup>41</sup>See Application, Exhibit SKWC 13, at 1.

<sup>42</sup>See id. at 4.

increase proposed by SKWC, and because no cost of service study was prepared to support a different allocation. In addition, despite the magnitude of the proposed rate increases, the Consumer Advocate did not recommend a phase-in of the increases.<sup>43</sup> The Consumer Advocate based this decision on the fact that none of the affected parties sought intervention in the docket or voiced objections to the increases during the public hearing. The Consumer Advocate also noted that there are no affordable or low income housing units within SKWC's service territory.

Based upon the foregoing factors cited by the Consumer Advocate, the commission finds that the Parties' stipulated rate design, which includes an across-the-board rate increase, is just and reasonable in this case. SKWC is reminded, however, that in its next rate case proceeding, it shall examine whether a different rate design, implementing both a fixed and volumetric rate, may more fairly recover the costs of providing service from each of SKWC's customer classes.

#### G.

##### Operating Reserve

The commission has previously found that an operating reserve is appropriate where a utility has a narrow margin of profit and an insubstantial rate base that are insufficient to adequately handle and accommodate unexpected repairs and

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<sup>43</sup>For rate increases above 25%, as in this case, the Consumer Advocate generally recommends that the increases be phased-in to minimize any "rate shock." In this instance, however, the Consumer Advocate does not recommend the phasing-in of the new rates, due to the reasons discussed above.

maintenance expenses. An operating reserve is therefore intended to pay for significant repairs, replacement, and unusual operating costs that are over and above normal maintenance costs (i.e., above those expenses provided for in the revenue requirement and base rates).

Consistent with these purposes, in Docket No. 96-0081, the docket granting SKWC its CPCN, the commission authorized SKWC to assess a charge of 10% to user fees to fund an operating reserve. The commission determined in that docket that SKWC's rate base amounted to \$91,666, and with a 10% authorized rate of return, SKWC had an opportunity to earn \$9,168 as a return on rate base. SKWC's Application in this docket seeks to continue the 10% assessment to user fees to fund an operating reserve.

In its Direct Testimony, the Consumer Advocate argued that SKWC should no longer be allowed to collect monies from ratepayers to fund an operating reserve. The Consumer Advocate asserted that SKWC will now be allowed an opportunity to earn a return on a Test Year average rate base of \$446,544, which is much larger than the rate base previously allowed, and that this return should be sufficient to cover extraordinary expenses. The Consumer Advocate also argued that the operating reserve should not be used simply to acquire property, plant or equipment. Instead, the funds are intended to pay for unexpected major repair and maintenance costs that were not foreseen in the rate setting process.

In settlement, the Parties reached an agreement that it would be preferable for SKWC to gradually eliminate the need for

ratepayer funding of an operating reserve, rather than eliminating the reserve entirely at this time. The Parties represent that the return on rate base determined in this proceeding is not sufficient to cover the costs of major unexpected repairs and maintenance expenditures. As a compromise, the Parties therefore agree to allow the continued collection of ratepayer funds in order to maintain an operating reserve, but at a reduced percentage of 6.5% on the approved monthly user fee rates for all customers.

The commission finds that the 6.5% assessment appears to be a sufficient level of funding to adequately maintain the operating reserve, while also reflecting the Parties' goal of gradually eliminating the need for ratepayer funding of the reserve. The commission accordingly finds the 6.5% value reasonable, and will allow SKWC to continue its operating reserve at this reduced rate.

#### H.

##### Rules and Regulations

The Consumer Advocate proposed two changes to SKWC's rules and regulations in its tariff. First, the Consumer Advocate recommended that SKWC replace the word "consumer" with "customer" throughout the company's rules and regulations, since there is no "consumption" of a product in this case (i.e., as opposed to water utilities). Second, the Consumer Advocate recommended that SKWC include a map of its service territory in its rules and regulations, similar to other utility companies.

The Parties agree in the Stipulation to the Consumer Advocate's recommended changes to SKWC's rules and regulations. The commission also finds reasonable the Parties' agreed-upon revisions to SKWC's tariff rules.

### III.

#### Ultimate Findings and Conclusions

This rate filing represents SKWC's first application for a general increase in its rates, since its inception of wastewater service in 1997.

The Parties have agreed to a rate increase of \$271,168, or 40.01% over present rates. The Parties have further agreed that this Stipulation allows SKWC an opportunity to recover an 8.85% rate of return on its average Test Year rate base of \$446,544.

The Parties' Stipulation results from arms-length negotiations, involving "give and take" on both sides. The commission finds that the Parties' Stipulation, taken as a whole, is just and reasonable. Accordingly, the commission approves the Parties' Stipulation, consistent with the terms of this Proposed Decision and Order.

The commission's approval of the Parties' Stipulation, or of the methodologies used herein, may not be cited as precedent in any future proceeding.

In the future, SKWC is strongly advised to seek rate relief on a more frequent basis, in order to minimize the

potential impact of the magnitude of its rate increases upon its ratepayers. In this respect, the commission notes:

1. The Parties agree to amortize SKWC's rate case expenses over a four-year period; and

2. Act 168 streamlines the rate application and ratemaking process for public utilities such as SKWC, with annual gross revenues of less than \$2 million.

In sum, the commission finds and concludes:

1. The operating revenues and expenses for the Test Year, as set forth in Exhibit A, attached, are reasonable.

2. SKWC is entitled to: (A) an increase in revenues of \$271,168, or 40.01% over revenues at present rates; and (B) a total revenue requirement of \$1,030,555.

3. The Parties' stipulated total Test Year amortization expense amount of \$23,050, and stipulated amortization period of four years, are reasonable.

4. A Test Year average rate base of \$446,544, which excludes a working cash amount that was originally requested by SKWC of \$69,031, is fair and reasonable.

5. SKWC is entitled to earn a rate of return of 8.85% on its Test Year average capital rate base, approved herein;

6. The Parties' stipulated rate design, which includes an across-the-board rate increase for all customer classes, is fair. In its next rate case proceeding, however, SKWC is directed to consider the feasibility of preparing a cost of service study, and examine whether a different rate design, consisting of both a fixed and volumetric rate, may more fairly

recover the costs of providing service from each of SKWC's customer classes.

7. SKWC is authorized to continue its operating reserve, but at a reduced rate of 6.5% of the approved monthly user fee rates for all customers.

8. The Parties' agreed-upon revisions to SKWC's tariff rules and regulations, are reasonable.

#### IV.

##### Acceptance or Non-Acceptance

Consistent with HRS § 269-16(f)(3), by July 12, 2006, each of the Parties shall notify the commission as to whether it:<sup>44</sup>

1. Accepts, *in toto*, the Proposed Decision and Order. If the Parties accept the Proposed Decision and Order, they "shall not be entitled to a contested case hearing, and [HRS] section 269-15.5 shall not apply." HRS § 269-16(f)(3).

2. Does not accept, in whole or in part, the Proposed Decision and Order. If so, said Party shall give notice of its objection or non-acceptance and set forth the basis for its objection or non-acceptance. Id. Moreover, the Party's objection or non-acceptance shall be based on the evidence and information contained in the current docket record, i.e., the

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<sup>44</sup>This deadline date is consistent with the deadline to move for reconsideration of a commission decision or order. See HAR §§ 6-61-137 (ten-day deadline to file motions for reconsideration); 6-61-21(e) (two days added to a prescribed period for service by mail); and 6-61-22 (computation of time).

materials available to the commission at the time of its issuance of the Proposed Decision and Order.

Any Party that does not accept the Proposed Decision and Order "shall be entitled to a contested case hearing; provided that the [P]arties to the proceeding may waive the contested case hearing." Id. The commission shall make every effort to complete its deliberations and issue its Decision and Order by September 30, 2006. Id.

The underlying purpose of Act 168 is to expedite the ratemaking process for public utilities with annual gross revenues of less than \$2 million. Consistent thereto, the commission has completed its review and timely issues this Proposed Decision and Order. Nonetheless, the commission makes it clear that if it is required to issue a Decision and Order due to the non-acceptance of the Proposed Decision and Order by one or both of the Parties, the commission is free to review anew the entire docket and all issues therein.

## V.

### Orders

#### THE COMMISSION ORDERS:

1. The Parties' Stipulation, filed on June 22, 2006, is approved, consistent with the terms of this Proposed Decision and Order.

2. SKWC may increase its rates to produce a total annual revenue increase of \$271,168, or 40.01% over present



rates, as shown on Exhibit A, attached, representing an increase in SKWC's revenue requirement to \$1,030,555.

3. Based on a total revenue requirement of \$1,030,555, SKWC's restructured rates will produce a rate of return of 8.85% on the average depreciated rate base for the 2006 Test Year, as shown on Exhibit A, attached hereto.

4. SKWC is authorized to continue its operating reserve, but at a reduced rate of 6.5% of the approved monthly user fee rates for all customers.


5. By July 12, 2006, SKWC shall file its revised tariff sheets and rate schedules for the commission's review and approval, which implement the tariff changes and increases in rates and charges authorized by this Proposed Decision and Order, with copies served upon the Consumer Advocate. SKWC's tariff changes and increases in its rates and charges shall take effect upon the commission's review and approval of said filing.

6. By July 12, 2006, each of the Parties shall notify the commission as to whether it accepts, *in toto*, or does not accept, in whole or in part, this Proposed Decision and Order. A Party's objection or non-acceptance shall be based on the evidence and information contained in the current docket record.

DONE at Honolulu, Hawaii

JUN 29 2006


PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By (EXCUSED)  
Wayne H. Kimura, Commissioner

By   
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

  
Kaiulani E.S. Kidani  
Commission Counsel

05-0333.cs

**DOCKET NO. 05-0333**  
**SOUTH KOHALA WASTEWATER CORP.**  
**REVENUE REQUIREMENTS**  
**TEST YEAR ENDED DECEMBER 31, 2006**

	Present Rates	Additional Amount	Proposed Rates
<b>REVENUES</b>			
User Rates	\$ 677,758	\$ 271,168	\$ 948,926
Sale of Effluent	80,629	-	80,629
Inspection Fees	1,000	-	1,000
Contribution for Replacement	-	-	-
Total Operating Revenues	<u>\$ 759,387</u>	<u>\$ 271,168</u>	<u>\$ 1,030,555</u>
<b>OPERATING &amp; MAINT. EXPENSES</b>			
Salaries & Wages	\$ 210,055		\$ 210,055
Payroll Taxes	16,821		16,821
Employee Benefits	36,255		36,255
Pension	45,400		45,400
Amortization	23,050		23,050
Bank Service Charge	3,360		3,360
Insurance	28,825		28,825
Maintenance & Repair	35,450		35,450
Office Supplies	1,750		1,750
Other Taxes & Licenses	400		400
Postage/Courier Services	350		350
Professional Services	49,860		49,860
Travel	3,680		3,680
Utilities	251,600		251,600
Contractor Services	63,000		63,000
Chemicals	22,120		22,120
Lab Supplies	2,500		2,500
Safety Supplies	750		750
Professional Development	4,790		4,790
Uniforms	3,000		3,000
Expense Transfer from Affiliate	61,594		61,594
Total O & M Expenses	<u>\$ 864,610</u>		<u>\$ 864,610</u>
Revenue Taxes	\$ 48,487	\$ 17,314	\$ 65,801
Depreciation	36,149		36,149
Income Taxes	-	24,476	24,476
Net Operating Expense	<u>\$ 84,636</u>	<u>\$ 41,790</u>	<u>\$ 126,426</u>
Net Operating Income (Loss)	<u>\$ (189,859)</u>	<u>\$ 229,378</u>	<u>\$ 39,519</u>
Average Rate Base	<u>446,544</u>		<u>446,544</u>
Return on Rate Base	<u>-42.52%</u>		<u>8.85%</u>

EXHIBIT A

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Proposed Decision and Order No. 22577 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

JOHN E. COLE  
EXECUTIVE DIRECTOR  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
DIVISION OF CONSUMER ADVOCACY  
P. O. Box 541  
Honolulu, HI 96809

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JOHN OKA  
VICE PRESIDENT/OPERATIONS  
SOUTH KOHALA WASTEWATER CORP.  
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Kihei, Hawaii 96753

  
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Karen Higashi

DATED: JUN 29 2006